DIFFERENCE BETWEEN ISLAMIC AND CONVENTIONAL INSURANCE

Before discussing the difference between Islamic and Conventional insurance it is better to first understand the concept of insurance and the objection of Shariah Scholars at it.

WHAT IS INSURANCE

Insurance provides the means for people to transfer the burden of uncertainty (of financial loss) to the insurer, for an agreed financial consideration called the "premium". In exchange, the insurer promises to provide financial compensation to the insured should a specified loss occur. It is an effective risk transfer mechanism by which individuals or organisations can exchange their uncertainty of financial loss (or risk) for the certainty of the premium. With a fixed premium, the insured is certain that he will not have to pay more for that year. This service of providing certainty of cost (fixed premium) is of immense value especially to organisations, as it would help them budget their expenditure confidently. This is the financial security provided by modern insurance.

The act of taking precautionary measures or `ikhtiar' against possible danger and its consequences is in line with the teachings of Islam. In the holy Quran it is clearly described how Prophet Yussof a.s. filled the grain silos from the surplus of seven years of good harvest as a protection to ensure the availability of continuous food during the seven lean years. This is a clear indication that one has to strive hard to avoid from being inflicted by any ill luck, and at the same time be fully prepared in terms of the measures taken as precautions in the event such an unfortunately eventuality cannot be avoided. One such measure available to every member of the community presently is the cover or protection provided by insurance policies.

As a concept, insurance actually does not contradict the teachings of Islam, as it is a method by way common resources are pooled in order to help the needy. Based on this, it is said that the operation of insurance as known today was established on the practice of blood money under the Arab tribal custom, which formed the basis of modern-day mutual insurance. In Asia, the practice of insurance was first established in the early second century of Islamic era when Muslim Arabs began to expand their trade to India, Malay Archipelago and other Asian countries. Because of the long distance, the voyage was hazardous and the traders often had to incur losses arising from a multitude of misfortunes.

Money Being Exchanged with Money

Shariah Scholars view the insurance contract as a transaction where money is being exchanged with money. Basically, the two parties to an insurance contract are exchanging the premium for claims both in monetary terms. Money is therefore viewed as the subject-matter of the insurance contract. It should be noted that treating the insurance contract as a contract for

exchange of money is not just a Muslim view but is also shared by some western writers. The following definition of an insurance contract from a textbook clearly shows that it is a contract of exchanging money for money:

"An agreement whereby one party, the Insurer, in return for a consideration, the premium, undertakes to pay to the other party, the Insured, a sum of money or its equivalent in kind on the happening of a specified event, which is contrary to the Insured's financial interest".

Malaysian Insurance Institute (MII) Text Book - Risk and Insurance.

Dr. Muslehuddin in his book, Insurance and Islamic Law said the following:

"The subject-matter is, therefore, risk coverage (compensation) sold in consideration of the premium. Insurance is thus, a species of contract of sale as is further evident from the policy"

Dr. Muslehuddin, Insurance and Islamic Law pg.129

Exchanging money with money in itself is not a problem so long as there is no difference in the amount or time involved. However, in the insurance transaction, the amount of premium and claim (both in terms of money) being exchanged are different and takes place at different times. This brings about the problem of *riba buyu'*. Another problem is that in many cases, the exchange does not take place because the event giving rise to the claim did not occur. This gives rise to another problem, namely *gharar* and *maisir*. The existence of these three elements is the only objections most Scholars have with insurance.

Insurance Business is in Conflict with the Injunction of Islam

Islam does not object to trade nor does it simply prohibit contracts just for the sake of it. What it seeks to ensure is justice and fair play in all dealings to all parties. Only those elements which could lead to exploitation of people or those deemed unjust by Shariah standards would be forbidden. What is basically useful to society would not be against the Shariah.

The objection is not against the concept of insurance but against the existence of the weaknesses in the insurance contract namely:

- *Gharar* (uncertainty);
- *Maisir* (gambling);
- *Riba* (usury).

In the first session, which was held at Mkkah Mukarrmah on Shaban 10, 1398 A.H. in the office of the Majlis-I-Fiqhi Islamia (the Assembly of Islamic Jurisprudence) deliberated on insurance and its difference branches and kinds. The vast amount of writings by the Ulama on this subject was also kept in view. Also kept in view was resolution # 55 of Saudi Arabia's Majlis-e-Hayat-I-Kibar-ul-Ulama (The Constituent Assembly of Most Eminent Religious

Scholars) passed in its tenth session at Riad held on 4.4.1397 A.H. declaring all kinds of commercial insurance as unlawful in Islam.

In the report, the council expressed the opinion that the main laws relating to insurance and the prepondering bulk of insurance business is in conflict with the injunctions of Islam, because:

1. There is '*gharar*' in these contracts,
2. The element of gambling is present in its extreme form,
3. There is an element of interest in these contracts and
4. Such arrangements come within the definition of '*akle-mal-batil*' i.e. unlawful acquisition.

The Council of Islamic Ideology of Pakistan gave a decision in December, 1983 that the well-known and current forms of insurance are in conflict with the Islamic injunctions.

"The contract of insurance, in all its forms, is unlawful, corrupt, false, prohibited and not promulgatable."

The report to the *"Badan Petugas Khas- Malaysia"* elaborated on the issue of *gharar* by describing the principles of contract according to Shariah as follows:

"The essential elements (rukun) of contract are 3, namely.
"Aqid" i.e. the parties to the contract;

"Ma'kud 'Alaih" i.e. the subject-matter of the contract (exchange of property, service or payment);

"Sighah" offer and acceptance.

One of the most essential elements with regard to the insurance contract is the rukun of "Ma'kud 'Alaih" . In insurance the exchange of the "Ma'kud 'Alaih" happens when the insured pays the premium in exchange for a promise of compensation arising from a specified event insured against. In view of this, the Scholars view insurance contracts as those for the exchange of goods or services."

Report to the "Badan Petugas Khas", pg. 18 para 2.6. (translation)

Similarly, Dr.Yusuf al-Qaradawi, does not think that the concept of insurance conflicts with the teaching of Islam. However, he does find certain practices of conventional insurance in need of modification to bring it in line with Islamic teachings:

"Our observation that the modern form of insurance companies and their current practices are objectionable Islamically does not mean that Islam is against the concept of insurance itself; not in the least – it only opposes the

means and methods. If other insurance practices are employed which do not conflict with Islamic forms of business transactions, Islam will welcome them".

The Lawful and The Prohibited in Islam (English translation) pg.276

Bringing Insurance in line with the Shariah

Although Islam is not inherently opposed to the idea of the insurance system, most Scholars are of the view that the insurance contract does suffer from certain weaknesses. As such, a new model of insurance could be developed under the broad principles and objectives of the Shariah.

In December, 1983, 'The Council of Islamic Ideology of Pakistan' expressed the following opinion about the lawful forms of insurance:

There is no repugnance in Shariah if insurance is undertaken with the sentiments of and is founded on cooperation, reciprocal responsibility, mutual surety and volition. If, therefore, an insurance company is established in such a manner that each one of its members is insured and all these insured persons enter into a mutual agreement of co-operation and reciprocal responsibility, then such agreement will be lawful in Shariah on account of the following reasons:

1. *The instalment paid by all the insured will not be with the intention of recompense but will be motivated by cooperation and mutual guarantee.*
2. *If on the occurrence of an incident, some amount is paid to an insured person, it will be considered to be an act of violation by all the insured members in which case speculation and co-relation is permissible.*
3. *As this procedure will not be for the purpose of profit, there will be no element of gambling or interest in it.*
4. *The money invested in this manner will not be lent out at interest but will be advanced or "Mudarabah" or for carrying on business on profit and loss basis.*
5. *Out of the invested amount, "qurz-e-hasn"' "loan without interest" may be advanced to any one of the insured at the time of need.*

If during the fulfilment of its public welfare responsibilities, the State, in place of the insurance companies presently based on Commercial foundations, establishes an institution, which may indemnify people on the occurrence of loss and may receive some small amount from the intending beneficiaries to avoid liability, it will be valid and permissible in Shariah.

Eleventh Report of the Council of Islamic Ideology-Pakistan on Islamization of Laws Page-12-13.

In one of the meetings of the working group of Council of Islamic Ideology-Pakistan for bringing insurance in line with Shariah held in 1987, the convener of the group, Dr.Ziauddin Ahmad, summed up the views of the Council of Islamic Ideology thus:

"The picture of insurance that emerges in the mind after reading the report of the council is that of a welfare and public-support institution founded on the principles of 'tabarro', 'takaful' and mutual assistance. (The dictionary meaning of the two words are, respectively, donation, free gift; contribution; subscription and reciprocal responsibility). That is why the council has given so much importance to mutual insurance. Hence, even if a small element of profit is a consideration for an insurance contract, it blemishes the image of insurance and goes contrary to its principle."

To bring insurance in line with Islamic principles, Dr. Qaradawi suggests in his book that certain modification be made to the insurance contract:

*"In my view insurance against hazards can be modified in a manner which would bring it closer to the Islamic principles by means of a contract of '**donation with a condition of compensation**'. The insured would donate his payments to the company with the stipulation that the company would compensate him, in the event that he is struck by calamity, with an amount which would assist him and reduce the burden of his loss. Such a type of transaction is allowed in some Islamic schools of jurisprudence. If such a modification is effected, and if the company is free of usurious business, one may declare insurance against hazards to be a lawful contract. However, as far as life insurance is concerned, I see it as being remote from Islamic business transactions."*

The Lawful and The Prohibited in Islam (English translation) pg.276

In the Takaful contract, the *"donation with a condition of compensation"* mentioned by Dr. Qaradawi is called *tabarru'*. This word is clearly mentioned in the proposal forms of Takaful Operators and thus becomes the basis of the contract. One of the functions of a Proposal Form is to enable those who wish to join the Takaful scheme to offer *('ijab')* themselves for inclusion. If the proposal is accepted *('qabul')* then a contract *('aqad')* has materialized.

This means that the Participants of Takaful schemes all agree to cooperate and be mutually responsible to help one another should a member suffer a defined loss. This spirit of a donation with condition or *tabarru'* when paying the premium is the fundamental difference between takaful and insurance.

WHAT IS TAKAFUL

The central idea of Takaful (Islamic insurance) contract is that it is a financial transaction of a mutual co-operation between two parties to protect one of them from unexpected future material risk. In a Takaful transaction, the party called the participant (insured) pays a particular amount of money known as the contribution (premium) to the another known as Takaful operator (insurer) with a mutual agreement that the insurer is under a legal responsibility to provide the participant with a financial protection against unexpected loss, should it happens within the agreed period. However, in a case whereby the loss does not occur against the insured within the specified period, the insured is entitled for the whole amount of paid-premiums together with the share of profits made out of the cumulated paid-premiums based on the

principle of al-Mudharabah financing technique. In such a transaction, both the insurer and the insured are mutually helping each other for financial protection.

DIFFERENCE BETWEEN TAKAFUL & INSURANCE

The fundamental difference lies in the fact that in the Takaful concept, the premium is paid on the basis of tabarru'. This changes the contract because with tabarru', it is the participants themselves who are carrying the risk and not the insurance company.
The Takaful operator is clearly not the owner of the fund but truly its custodian.

As such, the Takaful operator cannot use the contributions except as intended by the donors i.e. for mutual help.

By including the concept of tabarru', the element of gharar would be eliminated, which consequently eradicate maisir from the transaction. This is because with tabarru', the contract is no longer that of exchange, thus eliminating the problem of deliverability. In addition, the tabarru' factor also inculcates the spirit of solidarity, brotherhood and mutual help.

Takaful companies invest their funds in financial instruments, which are not forbidden by Islam. General Takaful companies maintain two separate and distinct accounts - one known as the Participants Fund and other Shareholders Fund. Takaful companies must have Shariah Supervisory Council to monitor their operation to make sure they do not engage in forbidden practices such riba;

Insurance	Takaful
• It is a business institutions operated based on the principles of contract.	• It is a co-operative institution based on the principles of contract for mutual co-operation (ta'awun).
• The basic service offered by the conventional insurance to the community is the transfer of the indeterminate fortuitous economic losses associated with the stipulated risks in return for a pre-determined payment known as premium. Thus it has been said and recognized that through the mechanism of conventional insurance, the insured substitutes certainly for uncertainly	• In Takaful which is based on the principle of mutuality member are insured and insurers themselves. All the losses are shared by the members themselves and as such to transfer of risk is involved.
• In the case of conventional insurance the primary motivation is to earn profit from the insurance transactions for the shareholders	• In Takaful shareholder of the company ,if any, are not entitled to participate in the profits generated by the insurance operators.

• The policy-holder in a conventional insurance company have no right to vote in the elections of the directors of the company or to see the annual accounts of the company	• In Islamic insurance companies these facilities are available to all members who pay a certain stipulated amount of premiums